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CHARLES ELMORE

No. 490

In the Supreme Court of the United States

OCTOBER TERM, 1935

BUS AND TRANSPORT SECURITIES CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT

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OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 7–11) is not officially reported. The opinion of the Circuit Court of Appeals (R. 15–18) is not yet officially reported.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on July 3, 1935. (R. 18–19.) The petition for certiorari was filed October 3, 1935,

and granted November 11, 1935. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

Corporation A wished to acquire all the stock in two bus lines, and the following plan was devised for that purpose. The individual who owned all the stock created corporation X, the taxpayer, and transferred to it all of the stock of the two bus lines in exchange for all the stock of X. On the other hand corporation A was affiliated with corporation B, which created corporation C and transferred to it certain preferred stock of corporation A in exchange for all the stock of C. Thereupon corporation X, the taxpayer, transferred the stock in the bus lines to corporation B in exchange for all the stock of corporation C. It does not appear that corporation X, the taxpayer, and corporation C performed any other function or served any business purpose after the transfer was effected. The questions presented are:

1. Whether under Section 112 (b) (4) and (i) of the Revenue Act of 1928 the continuity of interest required in connection with statutory reorganizations did not make it necessary that corporation X, the taxpayer, receive stock of B, rather than of C.

2. Whether the definition of the term "reorganization" contained in clause (A) of Section 112 (i)

(1), Revenue Act of 1928, should be limited to transactions which partake of the nature of mergers or consolidations.

STATUTES AND REGULATIONS INVOLVED

The pertinent statutes and regulations involved will be found in the Appendix, *infra*, pp. 17–19.

STATEMENT

The facts as found by the Board of Tax Appeals, which consisted of allegations in the petition admitted by the respondent's answer, may be summarized as follows (R. 8–9):

The Public Service Corporation of New Jersey (hereinafter called Public Service Company) desired to acquire two bus lines, the Butler-Newark Bus Line, Inc. (hereinafter called BN Company) and the Boonton-Mt. Lakes-Newark Bus Lines, Inc. (hereinafter called BM Company). One C. Easman Jacobus was the owner of practically all the stock of the two lines, which he had acquired for $28,500. The transfer was accomplished in the following manner, pursuant to plan:

The Public Service Coordinated Transport Company (hereinafter called Coordinated Company) organized C. Easman Jacobus, Inc., a corporation (hereinafter called Jacobus Company), and transferred to it in exchange for all of its capital stock 2,500 shares of 6% Cumulative Preferred Stock of the Public Service Company.

C. Easman Jacobus personally organized the Bus and Transport Securities Corporation, the taxpayer, and caused it to issue to him and his nominees all of its capital stock in exchange for all of the capital stock of the BN and BM Companies. Thereupon, on March 29, 1929, the Coordinated Company transferred to the taxpayer all the capital stock of the Jacobus Company and the taxpayer transferred to the Coordinated Company all the stock of BM and BN Companies. (R. 8.) At the time of the transfer, the fair market value of the stock of the Jacobus Company was $274,062.50. (R. 9.)

The taxpayer filed its return for the year 1929 and reported no gain or loss on the above-mentioned transaction. The Commissioner audited the return and determined that the taxpayer had realized a gain of $245,562.50, as a result of which there was a deficiency of $27,011.88. (R. 9.) The taxpayer appealed to the Board of Tax Appeals on the ground that the transaction fell within the provisions of Section 112 (b) (4) and (i) under which no gain or loss was recognized. The Board of Tax Appeals decided in favor of the Commissioner on the ground that there was no reorganization within the meaning of the statute. The taxpayer appealed to the Circuit Court of Appeals, which affirmed the decision of the Board of Tax Appeals.

SUMMARY OF ARGUMENT

I

The transfer of petitioner's assets to the Coordinated Company in exchange for stock of the Jacobus Company is not within the literal language of the statute because petitioner retained no interest in the company to which its assets were transferred. It is settled that in such a case the transferor must retain an intimate interest in the affairs of the transferee, and to satisfy this requirement it would have been necessary for petitioner to receive stock of the Coordinated Company. The fact that the Jacobus Company held stock of the Public Service Company, which was affiliated with the Coordinated Company, does not satisfy the statute, for petitioner had no voice in the management of the company which acquired its assets, and its proprietary interest in those assets had completely disappeared. Since its only interest must be traced through the stock of the Public Service Company, and this was preferred stock rather than common stock, the question arises whether it can be treated as representing a similar interest to that which petitioner held before. Upon this point reference is made to the brief for respondent in *John A. Nelson Company* v. *Guy T. Helvering, Commissioner of Internal Revenue,* No. 61, present term.

II

Moreover, we contend that the literal application of the statute is not permissible and that the definition of the term "reorganization" should be limited to transactions which partake of the nature of mergers or consolidations. Upon this point reference is made to the brief for the petitioner in *Guy T. Helvering, Commissioner of Internal Revenue* v. *Minnesota Tea Company,* No. 174, present term. We think that the transaction here involved does not partake of the nature of a merger or consolidation and is not within the purview of the statute. There was no plan relating to a change in the form of a business, but merely a plan to exchange certain assets. This Court has already held that the casting of such a transaction in the guise of a reorganization does not satisfy the statute.

ARGUMENT

I

WHERE ONE CORPORATION TRANSFERS ITS ASSETS TO ANOTHER, THE REQUIRED CONTINUITY OF INTEREST IS NOT SATISFIED UNLESS STOCK OF THE TRANSFEREE IS ACQUIRED IN EXCHANGE

The general rule of the statute is that the gain upon an exchange is taxable. To this there are certain well-defined exceptions. The petitioner contends that the transaction here involved is literally within the scope of one of the exceptions, namely,

Section 112 (b) (4) of the Revenue Act of 1928, which provides as follows:

> No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

Petitioner transferred its assets to another corporation in exchange for certain assets of the latter, but we submit that the assets received did not constitute stock or securities in another corporation a party to the reorganization, and hence that even the literal language of the statute is not applicable here.

Petitioner's assets consisted of all of the capital stock then issued and outstanding of bus line companies (the BN and BM companies). It transferred those assets to the Coordinated Company and received in exchange all of the capital stock of the Jacobus Company. (R. 8.) The only actual participants in the exchange were petitioner and the Coordinated Company. The latter acquired the stock of the bus lines, but petitioner acquired none of the transferee's stock. This Court has definitely held in *Pinellas Ice Co.* v. *Commissioner,* 287 U. S. 462, that when a corporation transfers its assets to another corporation in a transaction which is accepted as a statutory reorganization, the transferor must retain an intimate interest in the affairs of the

transferee. In that case one corporation transferred its assets to another corporation in exchange for cash and four promissory notes secured by bonds of the transferee company. This Court held that the transaction did not constitute a statutory reorganization, and said (p. 470):

> Certainly, we think that to be within the exemption the seller must acquire an interest in the affairs of the purchasing company more definite than that incident to ownership of its short-term purchase-money notes.

By the transaction in the instant case petitioner parted with its assets and acquired no interest whatsoever in the affairs of the transferee. Instead of acquiring stock of the transferee, petitioner acquired stock of a separate corporation, and we submit that petitioner did not retain the continuity of interest which the statute requires. This transaction merely represents an exchange of investments and has no relation to a change in the form of a business. Petitioner acquired the Jacobus securities and the Coordinated Company acquired the bus line securities. It is difficult to believe that Congress thought that a transfer of its holdings by each corporation to the other would serve any business purpose which should be encouraged by making the transaction tax free. The statute was designed to aid the reorganization of a business, and while the making of investments may be a business, an exchange of investments is not a reorganization of a business.

Petitioner contends that the requisite continuity of interest is preserved because the Jacobus Company, whose stock petitioner acquired, held 2,500 shares of 6% cumulative preferred stock of the Public Service Corporation of New Jersey, and the latter company was affiliated with the Coordinated Company, which acquired petitioner's former assets. We think this contention is untenable because the statute requires that the consideration for a transfer of assets shall be "stock or securities in another corporation a party to the reorganization," and the Jacobus Company was not a party to the exchange, nor a party to a reorganization. The purpose of this requirement, of course, is to limit the application of the statute to those formal changes which Congress had in mind in adopting the tax-free reorganization provisions and to confine the statute to cases where the old proprietors are employing the old assets in a new corporate form. If the assets go to one corporation and the taxpayer holds a proprietary interest in a different corporation, we think the taxpayer has severed his interest in the assets transferred.

After the transaction here in question the petitioner's assets were in the possession of the Coordinated Company and petitioner held stock in the Jacobus Company, which in turn held stock in the Public Service Company, which in turn was affiliated with the Coordinated Company. We think it is fanciful to suggest that such an at-

tenuated relationship represents a continuity of interest within the meaning of the statute, and we submit that the petitioner is further removed from its former assets than was the taxpayer in the *Pinellas* case, who held notes secured by bonds of the corporation holding the transferred assets. The definition in clause (B) of Section 112 (i) (1) is specific that the taxpayer must control "the corporation to which the assets are transferred", and we think that a relationship similar in kind is implicit in the clause (A) definition, although it does not indicate any required degree of interest.

The petitioner had no interest which gave it any voice in the management of the corporation holding its former assets and its proprietary interest in those assets had disappeared completely. We submit that this cannot be regarded as merely a formal change in position, and consequently that the transaction is not within the purview of the statute. We think that to satisfy even the literal language of the statute it would have been necessary for the petitioner to acquire stock of the Coordinated Company which held its former assets.

Moreover, since the Public Service Company stock held by the Jacobus Company was preferred and not common, and the record does not show it carried any voting rights, the question arises whether it can be treated as representing a similar proprietary interest to that which petitioner held in its former assets. Accordingly, we refer at this

point to the brief for respondent in *John A. Nelson Company* v. *Guy T. Helvering, Commissioner of Internal Revenue,* No. 61, present term.

II

THE TRANSACTION DID NOT PARTAKE OF THE NATURE OF A MERGER OR CONSOLIDATION

If it be held that the consideration petitioner received for its assets is properly regarded as a continuity of interest within the meaning of the statute, we then reach the question whether it is admissible to apply literally the definition of the term "reorganization" found in clause (A) of Section 112 (i), or whether it is to be limited to transactions which partake of the nature of mergers or consolidations. This question is presented in *Guy T. Helvering, Commissioner of Internal Revenue* v. *Minnesota Tea Company,* No. 174, present term, and is fully considered in the brief for petitioner in that case. Accordingly, we respectfully refer to Point I of the Argument in that case and incorporate it here by reference.

We submit that the transfer of petitioner's assets to the Coordinated Company in consideration of stock of the Jacobus Company is not within the purview of the statutory requirement for the following reasons:

1. The only plan referred to in the findings is the plan of the Public Service Company to acquire the stock of the bus lines which petitioner trans-

ferred in the transaction under examination. (R. 8.) The record contains no written agreement, no statement of verbal negotiations, no resolutions adopted by either corporation, and no instruments evidencing the transfer. The plan is therefore shown only by what was accomplished. The bus line stocks were owned by an individual, C. Easman Jacobus. He created the petitioner corporation and transferred the bus line stocks to the petitioner in exchange for the latter's stock. This was a tax-free transfer so far as C. Easman Jacobus was concerned. Section 112 (b) (5), Revenue Act of 1928. The direct transfer of stock by an individual would, of course, not be a reorganization, so that there would have been no basis for invoking the benefit of the reorganization provisions without a corporation to make the transfer. The Coordinated Company (an affiliate of the Public Service Company) caused a corporation to be organized to receive the assets from petitioner. This corporation took the name C. Easman Jacobus, Inc. and issued all its capital stock to the Coordinated Company in exchange for 2,500 shares of preferred stock of the Public Service Company. With these arrangements completed, petitioner transferred its assets to the Coordinated Company and received in exchange the stock of the Jacobus Company. These transactions occurred on the same day (March 29, 1929). (R. 8.) Thus the result is that the bus lines formerly owned by C. Easman Jacobus individually are now owned by the Coordi-

nated Company, while C. Easman Jacobus, the individual, is the stockholder of petitioner, and petitioner in turn is the sole stockholder of the Jacobus Company, and the latter in turn holds 2,500 shares of the Public Service Company's stock. Putting aside, as we must, the motive of tax avoidance, we submit that the record shows a plan having no relation to the business of either corporation participating in the transfer but a mere exchange of investments. There was no combination of business activities under a central management, but like the transaction in *Gregory* v. *Helvering,* 293 U. S. 465, 469, "a mere device which put on the form of a corporate reorganization as a disguise for concealing its real character, and the sole object and accomplishment of which was the consummation of a preconceived plan, not to reorganize a business or any part of a business, but to transfer a parcel of corporate shares to the petitioner."

2. After the transaction petitioner and the Coordinated Company existed at the same time, pursuing their separate activities. The petitioner remained in existence, its corporate form was not changed, its business did not pass into other hands, its stockholders did not change, nor did they acquire stock in the corporation which acquired petitioner's former assets. Petitioner's liabilities were not assumed by the Coordinated Company and the latter did not succeed to any corporate rights or privileges of the petitioner. As pointed out in the *Minnesota Tea Company* brief, these elements are

ordinarily present in mergers or consolidations, and it is significant that they are entirely wanting here.

Petitioner also contends that the transaction is a reorganization within the literal language of another portion of the definition in clause (A): "* * * the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation". Petitioner says that it acquired all the stock of the Jacobus Company and that the transaction was therefore literally within the quoted definition. However, since the only relief provision available to petitioner is Section 112 (b) (4), and it is predicated upon a transfer of assets, it is quite apparent that if the quoted definition is availed of by petitioner, it must be read as dealing with an acquisition of stock in exchange for assets. However, there are two other portions of the definition which specifically deal with transfers of assets,[1] and we submit that the definition quoted above must be

[1] Section 112 (i) (1) (A):

> * * * the acquisition by one corporation of * * * substantially all the properties of another corporation * * *.

Section 112 (i) (1) (B):

> a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred * * *.

limited to other fields. This definition is thoroughly discussed in the brief for the petitioner in *Guy T. Helvering, Commissioner of Internal Revenue* v. *Watts,* Nos. 184–186, present term, to which we respectfully refer the Court.

The need for this limitation is the more apparent when it is considered that although the definition in clause (B) dealing with a transfer of assets requires an 80% control of the transferee,[2] the portion of the definition here sought to be applied requires only a majority stock control. Petitioner's contention would therefore result in the anomalous situation of having two applicable definitions with conflicting requirements. Since two definitions deal specifically with transfers of assets, the ordinary rules of construction would seem to require that a specific provision must prevail over a more general provision. *Hellmich* v. *Hellman,* 276 U. S. 233. Applying that principle here, we submit that petitioner's application of the definition above quoted is clearly inadmissible.

CONCLUSION

In view of the foregoing, we submit that the decision below should be affirmed, either upon the ground that petitioner failed to acquire stock of the company to which it transferred its assets, and thus the literal language of the statute is inap-

[2] "Control" is defined in subdivision (j) of Section 112 as the ownership of "at least 80 per centum of the total number of shares of all other classes of stock of the corporation."

plicable, or because, in any event, it is not consistent with the purpose of Congress to apply the definition to transactions which do not partake of the nature of a merger or consolidation.

Respectfully submitted.

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NOVEMBER 1935.

APPENDIX

Revenue Act of 1928, c. 852, 45 Stat. 791, 816:

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) *Exchanges solely in kind.*—

* * * * *

(4) * * * No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

* * * * *

(i) *Definition of reorganization.* — As used in this section and sections 113 and 115—

(1) The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere

change in identity, form, or place or organization, however effected.

(2) The term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation.

* * * * *

(j) *Definition of control.*—As used in this section the term "control" means the ownership of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of the corporation.

Treasury Regulations 74, promulgated under the Revenue Act of 1928:

ART. 577. *Definitions.*—The term "reorganization," as used in sections 112, 113, and 115 means—

(1) A merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation),

(2) A transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred,

(3) A recapitalization, or

(4) A mere change in identity, form, or place of organization, however effected.

The term "a party to a reorganization" as used in sections 112 and 113 includes a cor-

poration resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation. This definition is not an all-inclusive one, but simply enumerates certain cases with respect to which doubt might arise.

A person is, or two or more persons are, "in control" of a corporation, within the meaning of section 112, when owning—

(1) At least 80 per cent of the voting stock, and

(2) At least 80 per cent of the total number of shares of all other classes of stock of the corporation.

As used in section 112, as well as in other provisions of the Act, the conjunction "or" is used to denote both the conjunctive and the disjunctive, and the singular is used to include the plural. For example, the provisions of article 574 are complied with if "stock and securities" are received in exchange as well as if "stock or securities" are received, and if securities in the same corporation, together with securities in another corporation a party to the reorganization or in other corporations parties to the reorganization, are received in exchange.

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